

In general, maintenance agreements that cover computer software and hardware are treated the same as maintenance agreements for other types of tangible personal property. The taxability of maintenance agreements depends upon if the charges for the agreements are included in the selling price of the tangible personal property. If the charges for the agreements are included in the selling price of the tangible personal property, those charges are part of the gross receipts of the retail transaction and are subject to tax. See 86 Ill. Adm. Code 130.1935. (This is a GIL).

June 22, 1999

Dear Ms. Xxxxx:

This letter is in response to your letter dated April 16, 1999 which we received on May 20, 1998. The nature of your letter and the information you have provided require that we respond with a General Information Letter, which is designed to provide general information, is not a statement of Department policy and is not binding on the Department. See 2 Ill. Adm. Code 1200.120(b) and (c), enclosed.

In your letter, you have stated and made inquiry as follows:

The purpose of this letter is to obtain a ruling that clarifies Regulation Section 130.1935(b). We believe that our M&E plans qualify as an exempt maintenance agreement and simply wish to have this confirmed by your department.

COMPANY is in the business of developing and licensing storage management software. A 'sale' consists of a license agreement for a customer to use one or more of COMPANY's software programs. The contract is either a perpetual or term license, such as a 3-year term. Once the contract expires, the customer is required to return or destroy all copies of our software. The contract itself is a qualified license agreement under Section 130.135(a).

In addition, COMPANY offers related services such as its M&E (maintenance & enhancement) plans. These plans can be ordered, cancelled or reinstated at the customer's option. M&E plans are optional software service maintenance contracts, similar to an extended warranty. They are separately stated and billed. Services provided consist primarily of telephone technical support. (Technical support services comprise up to 100% of the internal cost allocation.) However, the plan is for maintenance of a software product. One of the quirks of computer software is that there is no such thing as a 'bug free program'...only programs for which bugs haven't been found. As a result, the other part of the service contract is to fix problems which may be found after the release of the program. The

'enhancement' terminology refers to program repairs so the program(s) will perform as intended. Though repairs are seldom, they sometimes lead to the release of a subsequent program version. Customers with M&E plans are entitled to a copy of this release. It is important to note that list price for this license would not increase due to a new version, unless it happened to coincide with a general price increase for all products.

Upgrades are very different from M&E plans and the two should not be confused. Where a release (enhancement) contains program repairs, an upgrade changes the intended performance and use of the program. An upgrade is a product that must be separately ordered. Enhancements can not be separately ordered.

Our question to your department is 'Do our M&E plans qualify as exempt maintenance contracts for purposes of Illinois Sales and Use Tax?'

A copy of our standard licensing agreement has been included to aid in your determination. If you have any questions or need additional details, please call me at ####.

Sales of "canned" computer software are taxable retail sales in Illinois. See the enclosed copy of 86 Ill. Adm. Code 130.1935. If the computer software consists of custom computer programs, then the sales of such software are not taxable retail sales. See subsection (c) of Section 130.1935.

A license of software is not a taxable retail sale if:

- A) it is evidenced by a written agreement signed by the licensor and the customer;
- B) it restricts the customer's duplication and use of the software;
- C) it prohibits the customer from licensing, sublicensing or transferring the software to a third party (except to a related party);
- D) the vendor will provide another copy at minimal or no charge if the customer loses or damages the software; and
- E) the customer must destroy or return all copies of the software to the vendor at the end of the license period.

If transactions for the licensing of computer software meet all of the criteria provided in Section 130.1935(a)(1), neither the transfer of the software nor the subsequent software updates will be subject to Retailers' Occupation Tax.

As stated above, a license of computer software is not taxable if it meets all of the criteria listed in Section 130.1935(a)(1)(A-E). However, subparagraph

(D) requires the license to contain a provision requiring the vendor to provide another copy at minimal or no charge if the customer loses or damages the software. The Department has deemed a software license agreement to have met this criterion if the agreement does not contain such a provision, but the vendor's records reflect that it has a policy of providing copies of software at minimal or no cost if the customer loses or damages the software.

Subparagraph (E) also requires a license to require a customer to destroy or return all copies of the software to the vendor at the end of the license period. The Department has also deemed perpetual license agreements to qualify for this criterion even though no provision is included in the agreement that requires the return or the destruction of the software.

In general, maintenance agreements that cover computer software and hardware are treated the same as maintenance agreements for other types of tangible personal property. See Section 130.1935(b). The taxability of maintenance agreements depends upon if the charges for the agreements are included in the selling price of the tangible personal property. If the charges for the agreements are included in the selling price of the tangible personal property, those charges are part of the gross receipts of the retail transaction and are subject to tax. No tax is incurred on the maintenance services or parts when the repair or servicing is performed.

If maintenance agreements are sold separately from tangible personal property, sales of the agreements are not taxable transactions. However, when maintenance services or parts are provided under the maintenance agreements, the service or repair companies will be acting as service providers under provisions of the Service Occupation Tax Act that provide that when service providers enter into agreements to provide maintenance services for particular pieces of equipment for stated periods of time at predetermined fees, the service providers incur Use Tax based on their cost price of tangible personal property transferred to customers incident to the completion of the maintenance service. See 86 Ill. Adm. Code 140.301(b)(3), enclosed.

Charges for updates of canned software are fully taxable under Section 130.1935(b). If the updates qualify as custom software under Section 130.1935(c), they may not be taxable. But, if maintenance agreements provide for updates of canned software, and the charges for those updates are not separately stated and taxed, then the whole agreements would be taxable as sales of canned software.

Charges for telephone support, training, installation, configuration, and troubleshooting are exempt if they are separately stated from the selling price of canned software. See Section 130.1935(b). If these services are provided in conjunction with a sale of custom computer software or a license of computer software, the charges for those services are not subject to tax.

I hope this information is helpful. The Department of Revenue maintains a Web site, which can be accessed at www.revenue.state.il.us. If you have further

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questions related to the Illinois sales tax laws, please contact the Department's Taxpayer Information Division at (217) 782-3336.

If you are not under audit and you wish to obtain a binding Private Letter Ruling regarding your factual situation, please submit all of the information set out in items 1 through 8 of the enclosed copy of Section 1200.110(b).

Very truly yours,

Gina Roccaforte
Associate Counsel

GR:msk

Enc.